

STATE OF HAWAII  
DEPARTMENT OF LAND AND NATURAL RESOURCES  
Land Division  
Honolulu, Hawaii 96813

February 27, 2009

Board of Land and Natural Resources  
State of Hawaii  
Honolulu, Hawaii

PSF 03HD-153  
Hawaii

Report to the Board on Jacoby Development, Inc.'s  
Termination of the Kona Kai Ola Development Agreement for  
public lands at Kealakehe, North Kona, Island of Hawaii,  
Hawaii. Tax Map Keys: (3) 7-4-08: 71, 999, and portion of 3.

BRIEF SUMMARY:

On November 18, 2005, the State of Hawaii (through the Board of Land and Natural Resources or "Board") and Jacoby Development, Inc.'s ("JDI") entered into the Kona Kai Ola Development Agreement (the "Development Agreement"). The Development Agreement allowed JDI to pursue predevelopment activities necessary to develop its proposed Kona Kai Ola master-planned project on State-owned lands in Kealakehe, Hawaii.

At the September 26, 2008 Board meeting, staff informed the Board of JDI's decision to terminate the Development Agreement effective July 1, 2008. However, JDI testified at the meeting that it would be willing to withdraw its termination of the Development Agreement under the right circumstances. The Board recommended JDI and staff work together to see if there were mutually agreeable conditions under which the project could continue and for staff to report back to the Board.

JDI and staff have been unable to agree on terms and conditions under which DLNR and JDI could continue to pursue the Kona Kai Ola project. Therefore, JDI's initial decision to terminate the Development Agreement remains in effect.

SUBJECT PROPERTY:

Approximately 300 acres of public lands situated at Kealakehe, North Kona, Island of Hawaii, identified by TMKs (3) 7-4-08:71, 999, and portion of 03 ("Subject Property"). The Subject Property is located adjacent to the existing Honokohau Small Boat Harbor. (see **Exhibit A**)

OVERVIEW OF THE DEVELOPMENT AGREEMENT:

On April 25, 2003, as Agenda Item D-14, the Board approved the issuance of a Request for Qualifications / Request for Proposals

("RFQ/RFP") to solicit potential developers to develop the Subject Property. The RFQ/RFP was issued on January 23, 2004 and ultimately resulted in the State of Hawaii (through the Board) and JDI entering the Kona Kai Ola Development Agreement (the "Agreement") on November 18, 2005.

The Development Agreement contemplates JDI's development of a 500-acre master-planned project (known as "Kona Kai Ola") on the Subject Property and a 200-acre adjacent parcel owned by the Department of Hawaiian Home Lands ("DHHL") under ground leases from the two agencies for their respective properties.<sup>1</sup>

In general, the Development Agreement provides a process under which JDI is to seek the Board's approval of JDI's master plans for the project, allows JDI to conduct its due diligence activities, requires JDI to obtain all government entitlements, permits and approvals required to develop the project, and sets forth various other terms and conditions that JDI must fulfill before it will be issued a 65-year ground lease for the Subject Property.

The Development Agreement also requires JDI to pay a development fee of \$101,500.00 per year to the State in quarterly installments, commencing January 1, 2007.

The Development Agreement provides both JDI and the Board with certain rights to terminate the Agreement. For example, subject to notice and cure requirements, the Board may terminate the Development Agreement if JDI defaults on its obligations under the Development Agreement. In addition, Section 12 of the Development Agreement allows JDI to terminate the Development Agreement for certain reasons, including but not limited to, JDI's inability to obtain the necessary federal, State and county land use entitlements/approvals, or the imposition by any such government entities of onerous requirements or conditions on JDI's receipt of the necessary land use entitlements/approvals. The full text of Section 12 is attached as **Exhibit B**.

REMARKS:

By letter dated June 27, 2008, JDI notified DLNR of its decision to terminate the Development Agreement effective July 1, 2008 pursuant to Sections 12(a) and 12(c) of the Development Agreement.

At the September 26, 2008 meeting, staff informed the Board of JDI's decision to terminate the Development Agreement. However, JDI testified at the meeting that it would be willing to withdraw its termination of the Development Agreement under the right circumstances. The Board agreed to defer action for one month and requested that JDI provide the specific terms and conditions

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<sup>1</sup> JDI has already entered a separate 65-year ground lease with DHHL for the 200-acre DHHL parcel (the "DHHL Lease"). The effective date of the lease is January 1, 2004.

under which JDI would be willing to proceed with the Development Agreement. The Board recommended JDI and staff work together to see if there were mutually agreeable conditions under which the project could continue and for staff to report back to the Board.

By letter dated October 9, 2008, JDI indicated it would withdraw its termination of the Development Agreement under the following terms and conditions: (1) DLNR/BLNR agree to waive all development fees for three years, commencing January 1, 2008 through December 31, 2010; (2) DLNR/BLNR agree to defer the entitlement and related deadlines under the Development Agreement; (3) JDI and DLNR will re-examine the Kona Kai Ola project and determine if the currently proposed project remains desirable or whether the project should be revised; and (4) JDI will retain the right to terminate the Development Agreement if JDI determines, in its sole discretion, that the project is impractical, uneconomical, or other unfeasible. see **Exhibit C**.

DLNR, by letter from Chairperson Laura H. Thielen dated November 21, 2008, informed JDI that it did not consider the proposed terms and conditions to be acceptable or in the best interests of the State. Under JDI's proposal, the State would not receive any payments for three years while JDI retained the exclusive rights to 300 acres of State land. In addition, the State would be prevented or severely restricted in marketing, developing, or using the land during the three year period without any assurances that at the end of the three years, JDI could or would make any progress towards meeting the conditions set forth in the Development Agreement or developing the Kona Kai Ola project. DLNR provided JDI until December 31, 2008 to submit a revised and final proposal. Since no subsequent proposal has been received to date, JDI's election to terminate the Development Agreement effective as of July 1, 2008 remains in effect. See **Exhibit D**.

OTHER:

1. Development Fees (Agreement §5):

Section 5.1(b) requires JDI to pay to the State an annual development fee of \$101,500.00. The fee is to be paid in quarterly installments of \$25,375.00 on January 1, April 1, July 1 and October 1 of each year, commencing January 1, 2007.

Development fees still owed to the State by JDI up to July 1, 2008 (the effective date of JDI's termination of the Development Agreement) total \$50,800.00, plus late fees totaling \$350.00.

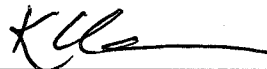
2. DHHL Lease:

According to DHHL, JDI is past due on payment of lease rents owed on its lease with DHHL for the 200 acres located adjacent to the Subject Property. DHHL is currently reviewing a proposal from JDI similar to the proposal received by DLNR.

SUMMARY:

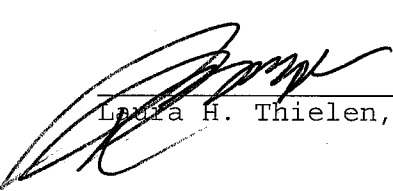
1. By letter dated June 27, 2008, Jacoby Development, Inc. ("JDI") terminated the Kona Kai Ola Development Agreement effective July 1, 2008 pursuant to Sections 12(a) and 12(c) of the Development Agreement.
2. JDI's termination is subject to the terms and conditions of the Development Agreement, including but not limited to, Section 12 which provides in part that JDI shall not be entitled to any compensation or other payment whatsoever by the State of Hawaii on account of its termination of the Development Agreement.
3. DLNR has not waived any rights of the State or the Board under the Development Agreement, including but not limited to, the right to seek payment of any fees or other sums owed by JDI to the State; unless otherwise directed by the Board, the Chairperson shall handle any post-termination matters with JDI.

Respectfully Submitted,




Keith Chun  
Planning and Development Manager

APPROVED FOR SUBMITTAL:



Laura H. Thielen, Chairperson



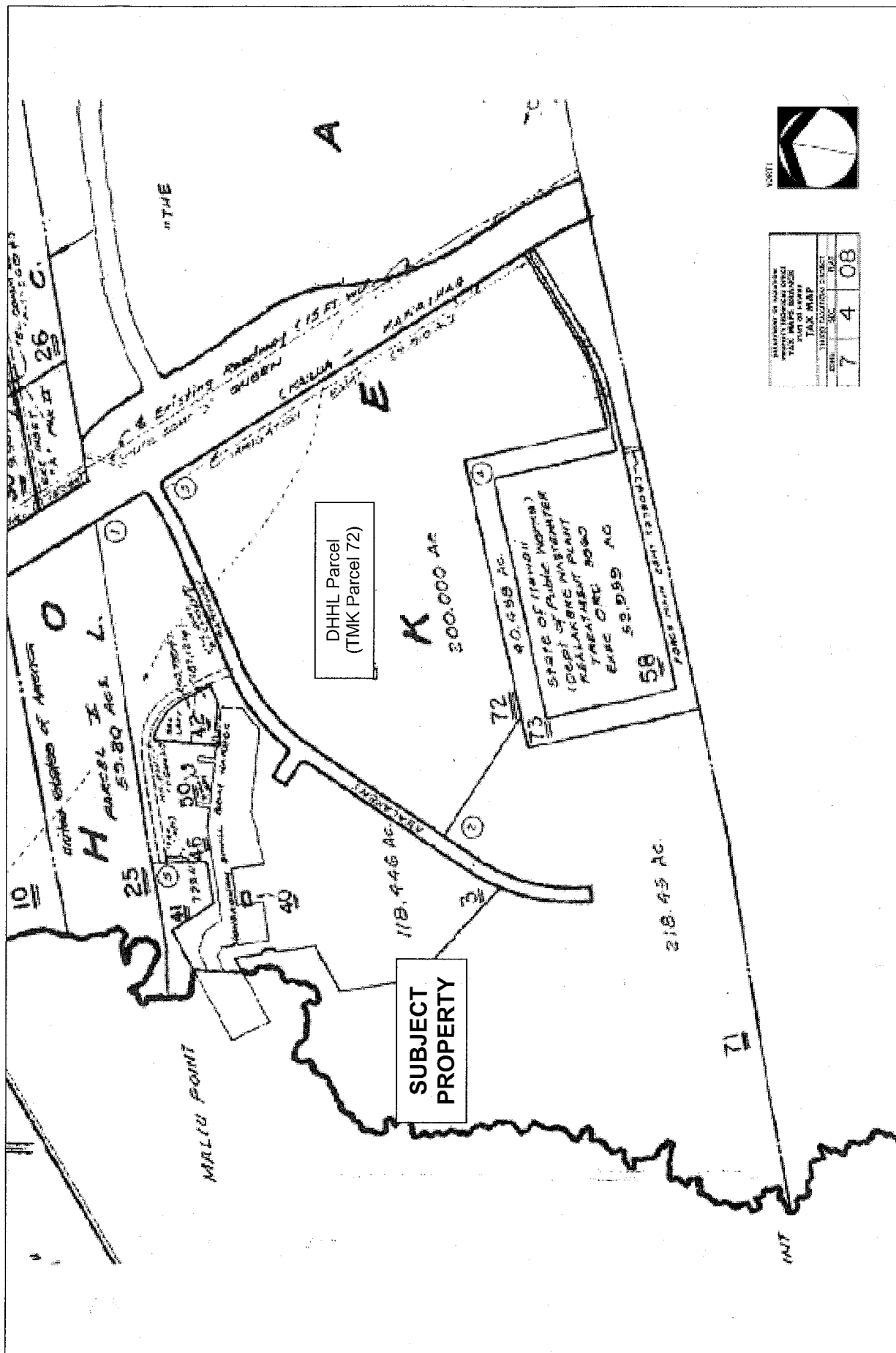


EXHIBIT A

## KONA KAI OLA DEVELOPMENT AGREEMENT - SECTION 12

### "12. Termination of Development Agreement by Developer.

Developer shall have the right at any time prior to the date occurring thirty-two (32) months after the date of preliminary approval of Developer's master development plan by the State (subject to extension in accordance with Section 11 and/or Section 24 hereof), exercisable at its option by giving written notice thereof to the State, to terminate this Agreement, if the contemplated development of the Property in accordance with the Preliminary Master Development Plan or Master Development Plan, as applicable, proves to be impractical, uneconomical or otherwise unfeasible as determined by Developer in its sole discretion, for any of the following reasons:

(a) Inability of Developer to obtain at any time and for any reason (1) the necessary federal, state or county land use, general plan, and zoning approvals to allow for the development of the Property in accordance with the Preliminary Master Development Plan or Master Development Plan, (2) approval of the State to changes proposed to the Preliminary Master Development Plan under Section 2.2 and/or the Core Infrastructure Plan under Section 4.3, or (3) approval for availability of sewer, water, electric and telephone services to the Property;

(b) Determination by Developer based on its environmental assessment and review of the Property that the Property is subject to environmental contamination, remediation and/or clean up issues which are deemed unacceptable to Developer in its sole discretion;

(c) Imposition by the United States of America, the State of Hawaii, and/or County of Hawaii of onerous requirements or conditions on the Developer's receipt of the necessary land use and zoning entitlements, permits or approvals to proceed with the development of the contemplated Kona Kai Ola Project in accordance with the Preliminary Master Development Plan or Master Development Plan, as applicable, which requirements or conditions are unacceptable to Developer in its sole discretion;

(d) Frustration of the contemplated development of the Property in accordance with the Preliminary Master Development Plan or Master Development Plan, as applicable, due to any bona fide action, lawsuit, administrative proceeding, or the like, instituted at any time by any third party; and,

(e) Inability of Developer to obtain financing adequate for the contemplated development of Core Infrastructure upon terms or conditions reasonably satisfactory to the Developer.

If Developer shall exercise its option to terminate this Agreement for any of the reasons above, Developer (i) shall not be entitled to any compensation or other payment whatsoever by the State on account of such termination or for any improvements constructed by Developer on the Property (if any), and (ii) shall deliver to the State, without cost or charge, copies of all plans, specifications, permits and studies prepared for or germane to the Property or part thereof."

# MCCORRISTON MILLER MUKAI MACKINNON LLP

ATTORNEYS AT LAW

October 9, 2008

## E-MAIL AND REGULAR MAIL

Ms. Laura H. Thielen  
Chairperson  
Department of Land and Natural Resources  
P. O. Box 621  
Honolulu, Hawai'i 96809

Re: Development Agreement dated November 18, 2005  
Kealakehe, North Kona, Island of Hawai'i  
Tax Map Key Numbers: (3) 7-4-08: 003 (por) and 071

Dear Ms. Thielen:

This letter serves as follow up to the discussions before the Board of the Department of Land and Natural Resources (the "Board") on September 26, 2008. At that meeting Jacoby Development, Inc. ("JDI"), through the undersigned, agreed to consider the withdrawal of its letter of termination dated June 27, 2008, effective July 1, 2008, with respect to that certain Development Agreement dated November 18, 2008 (the "Development Agreement"), subject to JDI proposing to you as the Director of the Department of Land and Natural Resources ("DLNR") certain deferrals and/or modifications to the Development Agreement which would allow for additional time for both JDI and DLNR to reexamine and analyze the feasibility of the Kona Kai Ola Project (the "Project") and moving it forward either as currently proposed and structured or in a redesigned and restructured format. If this concept and the proposal set forth below are acceptable to you and your staff, JDI understands that a submission will be made at the Board's second meeting in October to determine if the Board is in agreement with the proposed approach. If acceptable to you and Board, JDI will provide written confirmation of its withdrawal of its letter of termination. If, on the other hand, either you or Board determine that the proposal set forth below is not acceptable, then, and in such event, the JDI letter of termination dated June 27, 2008 will remain in effect and unchanged.

As I stated at the Board meeting, there is a clear difference of opinion between JDI and DLNR about how the Project got to this point. It is not my intent to rehash the arguments and counter arguments contained in the letters between JDI and your office on that subject, as that would be counter-productive at this time. However, because it is germane to any discussion about furthering the Project, I would note the obvious: this Project was conceived as a means by which Honokohau harbor and the surrounding fast lands owned by the State could be improved without the use of state funds. No one would describe Honokohau harbor as it was then and is now in superlative terms. As part of the RFQ/RFP, the selected developer was to consider the neighboring development on adjacent Hawaiian homestead land adjacent to and adjoining the

Ms. Laura H. Thielen, Chairperson  
Department of Land and Natural Resources, Land Division  
October 9, 2008  
Page 2

state owned harbor lands. In other words, both projects were intended to be developed in parallel. In addition, improvements to the marina basin containing 800 boats slips were made mandatory and essential to any development plan. As it turns out, JDI was the developer whose vision for the properties was selected by both departments. JDI engaged a number of local firms to assist in moving the Project forward.

Despite JDI's substantial financial and personal commitments, the Project has been beset by a variety of practical and political obstacles in dealing with the federal, state and county governments and their respective agencies, which caused JDI to reach the decision noted in its letter of termination that the Project was not currently feasible either economically or politically. The potential feasibility of the Project is not helped by the current turmoil in the financial and credit markets, and the significant slow down in not only the Hawaii, but the world-wide economy. Today all private developers find that demand for a mixed use commercial project such as planned for the DLNR and DHHL Lands at Kealahale has slowed dramatically, if not totally disappeared. In these times, attracting outside capital and retaining a portion of the workforce in gainful employment would seem to be worthy governmental goals. Also some of the practical and political obstacles encountered to date may dissolve or lessen over the coming months as the economic and political situation further evolves. All of the above indicates very strongly that unless the State wants to simply shelve this Project, it is prudent for both the State and JDI to pull back and re-examine the entire Project and to make a fresh determination based on the financial, economic, political, and real estate market conditions which exist today as they are significantly different from those which existed when the RFQ/RFP was issued by the State in January 2004.

Therefore it is in this vein that JDI proposes an amendment to Section 5.1 of the Development Agreement to provide for a waiver of all development fees for the period from January 1, 2008 to and including December 31, 2010, and to adjust the entitlement and related timelines under the Development Agreement which are a predicate to obtaining the Master Lease accordingly. During the calendar year 2009, JDI would be willing to commit to work with the DLNR staff to re-examine the Project, its size, scope and mix of uses in an effort to determine if the currently revised Project plan remains a desirable goal or whether the substantial change in conditions suggests that a revised Project plan would better serve the joint interests of JDI and DLNR and would have the full support of DLNR and the Board as it moves forward. JDI is also willing during this time period to explore partnering with other private or public agencies to provide assistance for the betterment of the Project and the greater Kona community.

If at the end of calendar 2009, JDI determines that the contemplated development of the Project remains impractical, uneconomical or otherwise unfeasible as determined in its sole discretion, for any of the reasons specified in Paragraph 12(a), (c), (d) and (e) of the Development Agreement, then the Development Agreement may be terminated upon notice to DLNR.



Ms. Laura H. Thielen, Chairperson  
Department of Land and Natural Resources, Land Division  
October 9, 2008  
Page 3

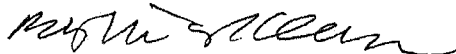
If the State is still committed to an effort to revitalize the harbor lands under an RFP for the lands at Kealakehe, as you mentioned at the Board meeting, I believe that it would take a lot longer than the extension period requested above to attract a new developer, negotiate a new lease, approve a development plan, etc, assuming any developer would even consider bidding on such an RFP in these tumultuous times. I submit that the best opportunity for the State to see a project in substantial conformance with the State's requirements being completed in the foreseeable future, however painstaking it may seem, lies with JDI.

I trust that you will understand and appreciate the rationale for the proposal made on behalf of JDI above, and that JDI remains ready, willing and able to work with you and the DLNR staff towards making a joint public/private sector project work on the DLNR lands at Kealakehe for the mutual benefit of JDI, the State and the general Kona community. However at this time there is no question in JDI's mind that nothing works without the benefit of additional time for both JDI and DLNR to reexamine and analyze the proper size, scope and mix of uses for the project to be developed on the Kealakehe lands.

If you have any questions or wish to discuss this matter further with me or Messrs. Jacoby or Condra of JDI, please contact me.

Sincerely,

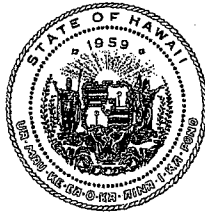
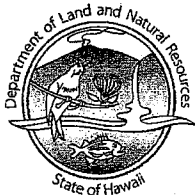
McCorriston Miller Mukai MacKinnon LLP



Robert G. Klein

cc: James Jacoby  
Scott Condra

LINDA LINGLE  
GOVERNOR OF HAWAII



**STATE OF HAWAII**  
**DEPARTMENT OF LAND AND NATURAL RESOURCES**

POST OFFICE BOX 621  
HONOLULU, HAWAII 96809

LAURA H. THIELEN  
CHAIRPERSON  
BOARD OF LAND AND NATURAL RESOURCES  
COMMISSION ON WATER RESOURCE MANAGEMENT

RUSSELL Y. TSUJI  
FIRST DEPUTY

KEN C. KAWAHARA  
DEPUTY DIRECTOR - WATER

AQUATIC RESOURCES  
BOATING AND OCEAN RECREATION  
BUREAU OF CONVEYANCES  
COMMISSION ON WATER RESOURCE MANAGEMENT  
CONSERVATION AND COASTAL LANDS  
CONSERVATION AND RESOURCES ENFORCEMENT  
ENGINEERING  
FORESTRY AND WILDLIFE  
HISTORIC PRESERVATION  
KAHOOLAWE ISLAND RESERVE COMMISSION  
LAND  
STATE PARKS

November 21, 2008

VIA FACSIMILE: (770) 206-9150  
ORIGINAL BY US MAIL

Mr. James F. Jacoby, Chairman  
Mr. Scott Condra, Senior Vice-President of Development  
Jacoby Development, Inc.  
171 17<sup>th</sup> Street, NW, Suite 1550  
Atlanta, Georgia 30363

Re: Kona Kai Ola Project

Dear Messrs. Jacoby and Condra:

By letter from Mr. Robert G. Klein dated June 27, 2008, Jacoby Development, Inc. ("JDI") terminated the Kona Kai Ola Development Agreement, effective July 1, 2008. At the September 26, 2008 meeting of the Board of Land and Natural Resources ("BLNR"), DLNR staff informed the BLNR of JDI's termination of the Development Agreement. However, Mr. Klein appeared at the same meeting and indicated that JDI was willing to consider withdrawing its termination of the Development Agreement under the right circumstances. Mr. Klein asked for time to see if DLNR staff and JDI could work something out. The BLNR requested that JDI provide the specific terms and conditions under which JDI would be willing to proceed with the Development Agreement.

By letter dated October 9, 2008, Mr. Klein indicated that JDI would withdraw its letter of termination under the following terms and conditions: (1) DLNR/BLNR agree to waive all development fees for three years, commencing January 1, 2008 through December 31, 2010; (2) DLNR/BLNR agree to defer the entitlement and related deadlines under the Development Agreement; (3) JDI and DLNR will re-examine the Kona Kai Ola project and determine if the currently proposed project remains desirable or whether the project should be revised; and (4) JDI retains the right to terminate the Development Agreement if JDI determines, in its sole discretion, that the project is impractical, uneconomical, or other unfeasible.

DLNR does not consider the proposed terms and conditions to be acceptable or in the best interests of the State. Under JDI's proposal, the State would not be paid anything for JDI having the exclusive right to develop over 300 acres of the State's land for three years. During that time, the State would be prevented or severely restricted in marketing, developing, or using the land. In addition there is no guarantee that in the three years, JDI could or would make any progress towards meeting the conditions set forth in the Development Agreement or developing the Kona Kai Ola project, e.g., obtaining approval of master plans and obtaining required federal, state and county entitlements. In fact, at the end of the three years, the State could end up in the very same place where it is today.

**EXHIBIT D**

Mr. James F. Jacoby, Chairman  
Mr. Scott Condra, Senior Vice-President of Development  
Jacoby Development, Inc.  
November 21, 2008  
Page 2

Since DLNR does not consider the proposed terms and conditions to be acceptable, we request that JDI submit its best and final offer to DLNR by no later than December 31, 2008. In evaluating any such offer, DLNR intends to communicate with the Department of Hawaiian Homelands before making a recommendation to the BLNR. If JDI does not submit its best and final offer by the stated deadline, DLNR will report to the BLNR that no agreement has been reached, and that as provided in Mr. Klein's letter dated October 9, 2008, JDI's termination of the Development Agreement remains in effect.

Very truly yours,



Laura H. Theilen  
Chairperson

cc: Robert G. Klein, Esq.